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AMERICAN ACCOUNT Irwin Stelzer

Clinton makes losing bet by backing yen

SUDDENLY investors have decided they are not, after all, immune to Asian contagion. Never mind that cautious market-watchers such as Alan Greenspan, the Federal Reserve chairman, said shares might be overpriced long before the Asian tigers became mere pussycats - or that economists now say the American economy is slowing and, with it, corporate profits growth, a factor sufficient in itself to drive shares down. Rather than apologise for ignoring Greenspan or assuming profits are a tree that can grow to the sky, analysts prefer to the lay the apparent triumph of Wall Street's bears at the door of Asia or, more precisely, of Japan.

This is ironic. For years America has feared Japan's economic success, which many saw as coming at the expense of domestic industry. Now, Japan's economic collapse is also seen as threatening American prosperity. The Japanese must feel they are damned if they succeed and damned if they fail.

And fail is what they are now doing. Japan's economy is contracting at an annual rate of about 5%, unemployment is rising, the banking system is insolvent, and old-line politicians are lurching this way and that in search of a solution to the country's ills. And the yen is diving.

Consumers, thrifty in normal times, have turned into hoarders, accumulating $9 trillion in liquid assets, of which an increasing amount is in dollars and D-marks as confidence in the yen wanes. Japan's equivalent of the man on the Clapham omnibus knows his government is already deeper in debt than, say, Italy's.

Add to the admitted debt the cost of salvaging the banks and paying off the railway system's hidden debts, and Japan's triple-A bond rating will soon be history. That will raise even further the cost of the borrowing the government must do to finance its programme of tax cuts and public works. So the Japanese fear their government will not be able to pay their pensions - little wonder that the only things on which they are spending are safes and safety-deposit boxes, both of which are in short supply.

Allen Meltzer, a Carnegie Mellon University economics professor whose views carry weight in Japan, says consumers have, in the last decade, seen home values fall by two-thirds and share values fall 60%. In Japan, cash is king.

The government's uncertain response is understandable, for the advice it is getting is inconsistent. Sensible economists, such as Meltzer, tell Tokyo to let the yen drift down, perhaps to Y160 against the dollar, the level in 1991. That would stimulate exports and give industry a shot in the arm.

But the Clinton administration opposes such a move, famously intervening on June 18 to stabilise the Japanese currency. Robert Rubin, treasury secretary, who meets Tokyo officials next month, feared a further fall would prompt the Chinese to devalue, touching off a new wave of competitive devaluations in Asia. So he has persuaded Keizo Obuchi, the new prime minister, to pledge to strengthen his currency.

Such a policy, if it could succeed - and observers such as Jeffrey Schafer of Salomon Smith Barney doubt that even the combined might of Japan and America can long buck the fundamentals weakening the yen - would force Japan to deflate even more. A stronger yen, unless offset by price cuts, would make Japanese products more expensive, cutting sales and forcing more layoffs and bankruptcies. But price cuts would be more than many shaky Japanese firms can survive. Furthermore, the higher interest rates needed to strengthen the yen would push more endebted firms over the brink, and bring down more of Japan's tottering banks as borrowers defaulted.

But politics trumps economics every time in the White House. And Clinton is staking his Asia policy on forging an alliance with the Chinese. So when China told him to shore up the yen, he did so. Meanwhile, Beijing is said to be engaging in a covert devaluation - making exports cheaper through subsidy rather than by devaluing the yuan.

China watchers say Beijing feels it will lose popular support if unemployment rises further. It has already taken the risk of antagonising the army by ordering it to sell its business interests, and is thus doubly eager to avoid confrontation with workers thrown out of work by the closure of inefficient businesses and the fall in inward investment resulting from the Asian crisis and its own propensity to change the rules governing such investment.

So Beijing wants America to support the yen and other Asian currencies, lest Japanese and other goods become cheaper and wrest sales from China. But, as John Makin, an economist at Caxton Corporation, says: "Stabilising the currency deprives a nation experiencing deflationary pressure of the only means available to stimulate demand for its products." Rubin, who understands markets well, knows that. But his boss seems willing to see Japan's pain extended to placate Beijing.

Just as politics trumps economics in Washington these days, in the long run markets trump men. Barring a miraculous turnround in Japan, the men who think their interventions can return the yen to its former heights are doomed to disappointment. Japan's politicians talk about Y130 to the dollar; Meltzer talks about Y160. Gamblers should bet on Meltzer.

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